Secret

[redacted] 25X1

DIRECTORATE OF INTELLIGENCE

WEEKLY SUMMARY

State Dept. review completed

Secret

43

7 August 1970
No. 0382/70

Approved For Release 2008/11/04 : CIA-RDP79-00927A008100030001-1

Page Denied

CONTENTS

(Information as of noon EDT, 6 August 1970)

MIDDLE EAST - AFRICA

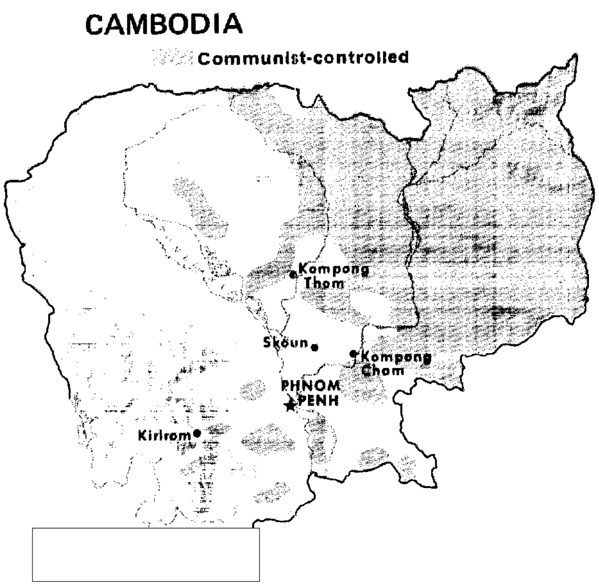
WESTERN HEMISPHERE

FAR EAST

Cambodia: *Some Wins, Some Losses*

In the most significant military action in nearly a month, government forces repulsed a series of Communist attacks on the isolated provincial capital of Kompong Thom Province. Enemy troops occupied most of the key buildings in Kompong Thom city in the early stages of the fighting. Government defenders, supported by numerous air strikes, doggedly fought back to drive almost all of the Communists out of Kompong Thom. The deputy chief of staff of the Cambodian Army claimed that 200 Communists died in the fighting, while government forces suffered 42 killed.

Enemy forces remain in a position to direct harassing small-arms and mortar fire against the heavily damaged city, and it is possible that they will make new ground attacks on it.



25X1

99530 8-70 CIA

The Cambodian Army's tenacious defense of Kompong Thom for the second time in two months should help boost morale throughout the army. It may also help compensate for the government's thus-far fruitless effort to retake the mountain resort town of Kirirom, southwest of Phnom Penh. There are signs that the next round in this effort might be postponed indefinitely. Cambodian Army soldiers in the Kirirom area have been plagued by bad weather, supply shortages, and illness. Moreover, enemy harassing attacks along Route 4 southeast of Kirirom have complicated the movement of reinforcements and supplies to support the offensive.

The immediate purpose of the Communist campaign around Kirirom may be more for psychological effect than for significant military advantage. The Communists may hope that with relatively minimum effort they can expose anew the Cambodian Army's existing tactical shortcomings, but the enemy may have some longer range objectives, such as establishing a secure rear base of operations in the remote mountainous areas of southwestern Cambodia. Such a base could be used for launching attacks on government positions and lines of communications in the surrounding provinces.

Elsewhere, in Kompong Cham Province, the town of Skoun at the junction of Routes 6 and 7 between Kompong Thom and Kompong Cham cities was captured by the Communists at the same time they attacked Kompong Thom. Government reinforcements, including three Khmer Krom battalions sent from Phnom Penh, converged on Skoun on 5 August, but their initial attempts to reoccupy it failed. The attack on Skoun may be the first step in an enemy effort to increase pressure on Kompong Cham city, which has been subjected to only light harassment since mid-May.

On the political front, the government reportedly is planning to move ahead with its efforts to revise the constitution along republican lines. Lon Nol apparently intends to announce soon the investiture of the National Assembly as a constituent assembly in order to adopt a new constitution.

25X1

25X1

25X6

Laos: *Proposal and Counterproposal*

The skepticism about the chances for significant peace talks in the near future, which had been expressed by Pathet Lao spokesmen last week, seems to have been confirmed by the message that Communist envoy Souk Vongsak delivered to Prime Minister Souvanna Phouma on 3 August. The letter from Pathet Lao chief Souphanouvong disclosed no new inducements for a settlement and dwelt at length on the Communist leader's regret that Vientiane had not made a "positive response" to his peace proposals of 6 March 1970.

Souphanouvong's text employed language that could hardly have been intended to improve the atmosphere between the two sides. He claimed that the Pathet Lao peace proposals had been "intentionally distorted" by the government and that the "Americans and their lackeys have combined to intensify the criminal war against our people." Taking a somewhat sanctimonious tone, the Pathet Lao leader then stated that his side would be "persevering nonetheless in its just position and in its attitude of good will."

25X1 [redacted]

25X1 [redacted] The only concrete proposal contained in the note was that Souvanna should appoint a plenipotentiary to meet with an as-yet unknown negotiator from the Communist side to "discuss questions aimed at creating a favorable situation for the meeting of the interested Lao parties." In effect, Souphanouvong only proposed that, after the current conversations in Vientiane between Souk and Souvanna, there should be another stage of exploratory talks before substantive negotiations could begin.

It is possible that the letter from Souphanouvong did not constitute all that has been communicated to Souvanna in the way of peace proposals. [redacted] 25X1

25X1

On the military front, the situation remained unexpectedly quiet except near the Plaine des Jarres where the Communists staged two heavy attacks on a government battalion manning defensive positions near the Tha Tam Bleung outpost. North Vietnamese troops attacked in strength on 31 July and on 3 August, inflicting heavy casualties and then retiring from the scene. These assaults, which represent a significant break in the normal low level of activity in the north during the rainy season, could have been intended to demonstrate Communist strength as talks with the government got under way or, perhaps more likely, they may have been only another effort to keep government forces contained in their present positions. [redacted] 25X1

♦ ♦ ♦

Vietnam: *No Deals with the Enemy*

Thieu Again on Cease-Fire

President Thieu explained his thinking on a cease-fire in some detail in a broadcast to the nation on 31 July, emphasizing two somewhat contradictory points. First, he reassured the war-weary population that the government stands ready to take every reasonable step to achieve peace, dwelling at length on his proposal of 11 July 1969 for elections with Communist participation. Thieu again indicated that he would be willing to consider accepting a standstill cease-fire before an over-all political settlement is negotiated.

The bulk of the speech, however, was designed to stop growing speculation in South Vietnam that a cease-fire might be announced soon. Thieu laid great stress on the need to negotiate conditions for any cease-fire. He again asserted that there must be effective supervision and a tight control apparatus to prevent the Communists from reinforcing and resupplying their forces and to prevent terrorist activity.

The President also stressed that a standstill cease-fire would not involve ceding political control of areas where enemy forces might be strong. Instead, a cease-fire would be a way to stop the killing until an over-all settlement is arranged that would allow the Communists to participate in internationally supervised elections. A cease-fire could only be justified, Thieu said, if there were real progress in the negotiations. He made it amply clear, however, that he expects no such progress soon.

While trying to maintain a flexible and forthcoming posture, Thieu clearly wanted to reassure the armed forces and the people at large that his government is not about to drop its guard. He probably also wanted to head off any tendency among security forces to avoid battle with the enemy in the belief that a cease-fire is imminent. Moreover, some of his language seems to have been intended to caution political leaders, including candidates in the upcoming senate elections, against encouraging antiwar sentiment by developing a campaign around the peace issue.

Communists Cautious on Cease-Fire

The Communists are being very wary of President Thieu's cease-fire talk. There has been no propaganda comment on his several recent statements of willingness to talk about a cease-fire, including the speech last week in which he spelled out his position. Although there was extensive indoctrination of Viet Cong cadre as early as the fall of 1969 on the possibility of an early cease-fire, all such discussions—none of which was very specific in any case—have been tightly held.

By not responding directly to President Thieu's statements, the Communists give the impression that they are not opposed to talking about a cease-fire. They are not, however, taking any initiative in this direction, and they are not providing any clues as to their real position.

Most of the evidence of Communist planning for a cease-fire being turned up in South Vietnam does not suggest that the enemy considers such a step a real possibility at present. Such planning usually focuses on some substantial allied concessions toward an interim political settlement which includes a truce.

25X1

Some reports reflect a measure of confidence that more US troop withdrawals and the government's economic problems eventually will create new political opportunities for the Communists.

Other reports stress the deep misgivings some Communist cadre have about what might happen in the event of a cease-fire. Communist supporters might be quickly rounded up and imprisoned or executed by Saigon police if they agree to lay down their arms prematurely.

These accounts reflect the mixed Communist feelings about the opportunities and dangers of a cease-fire. Some cadre apparently would welcome a truce and believe that Communist political skills in organization, subversion, and agitation could quickly undo the South Vietnamese Government. Others fear a massacre. Although the Communists have preserved all their options for a cease-fire situation by never publicly staking out a position, they probably calculate that substantial allied concessions, at least in terms of guaranteed security and freedom of action for some of their followers, would be required before the advantages would outweigh the dangers. They apparently see little opportunity of obtaining such concessions at this time, and President Thieu's apparent growing confidence will probably reinforce the Communist belief that the chance of obtaining any real security guarantees is remote.

War Action Remains Generally Light

Action in the ground war in South Vietnam remains generally light, although Communist forces are staying in the field and making occasional stabs at allied positions. During the week the enemy stepped up shelling attacks in two delta provinces, and South Vietnamese territorial security forces suffered fairly heavy losses at several outposts throughout the countryside. For example, one enemy assault on a South Vietnamese position in the upper delta early in the week resulted in nine South Vietnamese dead and more than 50 wounded.

25X1

Madame Binh Strikes Out

The visit of Viet Cong Foreign Minister Madame Binh to India on its own merits was a distinct disappointment to the Communists. Madame Binh pressed the case for diplomatic recognition, but the Indians were apparently negative both for the present and the immediate future. 25X1 25X1

Even from a purely public relations standpoint, the visit—the first high-level extended tour of a nonbloc country by such a high-ranking Viet Cong personality—must have fallen short of Communist expectations. The visit was played in very low key and, although Madame Binh was received at the highest government levels of the Indian Government, her public appearances were confined largely to those with leftist groups that already support the Viet Cong cause. The Indian Government planned her itinerary to prevent local leftists from exploiting her presence, and it is doubtful that she made any important new converts or had a significant impact on Indian public attitudes toward the war.

The visit did have an unexpected byproduct, however, as a result of Saigon's efforts to counter it. The South Vietnamese sent two Viet Cong defectors to India to try to steal some of Madame Binh's thunder, but this move succeeded mainly in annoying New Delhi. Subsequent anti-Saigon demonstrations in India and anti-Indian demonstrations in South Vietnam further escalated the incident and created new strains in New Delhi - Saigon relations. It may also have generated some internal problems within the South Vietnamese Foreign Ministry. The new difficulties thus generated for Saigon no doubt helped offset Hanoi's disappointment over the visit itself. 25X1

◆ ◆ ◆

Communist China: *People's Congress in the Works?*

Preparations appear to be well under way for the convening of the long-delayed National People's Congress (NPC)—the civil government counterpart to the national party congress held last year. When it convenes, it is expected to treat important matters left over from the Cultural Revolution period, including the selection of a new chief of state and the formal restaffing and restructuring of various central government organs. In the past, these congresses have also served as forums for a wide-ranging review of foreign and domestic policies, but, given the still fragile and delicately balanced nature of China's central leadership, the gathering may restrict itself to achieving certain minimum political objectives.

Although in the past year or so the congress apparently has been repeatedly postponed, presumably because of factional quarreling over personnel and policy issues, the machinery seems to have been finally put in motion for the convening of a congress. Signs pointing in this direction include the issuance on 23 July at the local level of a national "directive" urging the populace to prepare for the "imminent" opening of the congress, and reports of the departure of rank-and-file congress delegates to Peking from the Canton area.

The congress almost certainly will name a successor to ousted chief of state Liu Shao-chi and may spell out in some detail the structural alignment of the central government apparatus. If major personnel assignments are announced, they may shed some light on the continued absence of politburo member and public security minister Hsieh Fu-chih, who has been out of public view since 19 March. Hsieh is a vice premier, and his failure to be reappointed would be conclusive proof that he has been purged—the first casualty on China's new 25-man ruling politburo.

The NPC may also provide a convenient rostrum for proclaiming a fourth five-year plan, if Peking can see its way clear to take such a step, implying as it does additional burdens for national administration while reconstruction of the party apparatus is still incomplete. The immediate significance of such a plan, however, would probably be more propagandistic than economic. The economy has been able to function without long-range planning for years. A third five-year plan (1966-70) nominally exists, but the intercession of the Cultural Revolution and its attendant turmoil in 1966-68 removed any possibility that it would be implemented.

A plan is becoming increasingly desirable, however, in order to shape rather than catch up with events. Much work on its primary task, that of establishing priorities, has already been done. It is clear, for example, that defense is being given first consideration and that strategic industries such as petroleum, iron and steel, and rail transport are undergoing important expansion. Agriculture is receiving some help from the state, but light industry, which produces consumer goods, is at the bottom of the list. A new plan would probably not bring major changes in policy but might facilitate enforcement of the key measure in the regime's investment policy: placing most of the burden for financing agricultural development on the rural sector while channeling increased central government resources to defense and strategic industries. 25X1

◆ ◆ ◆

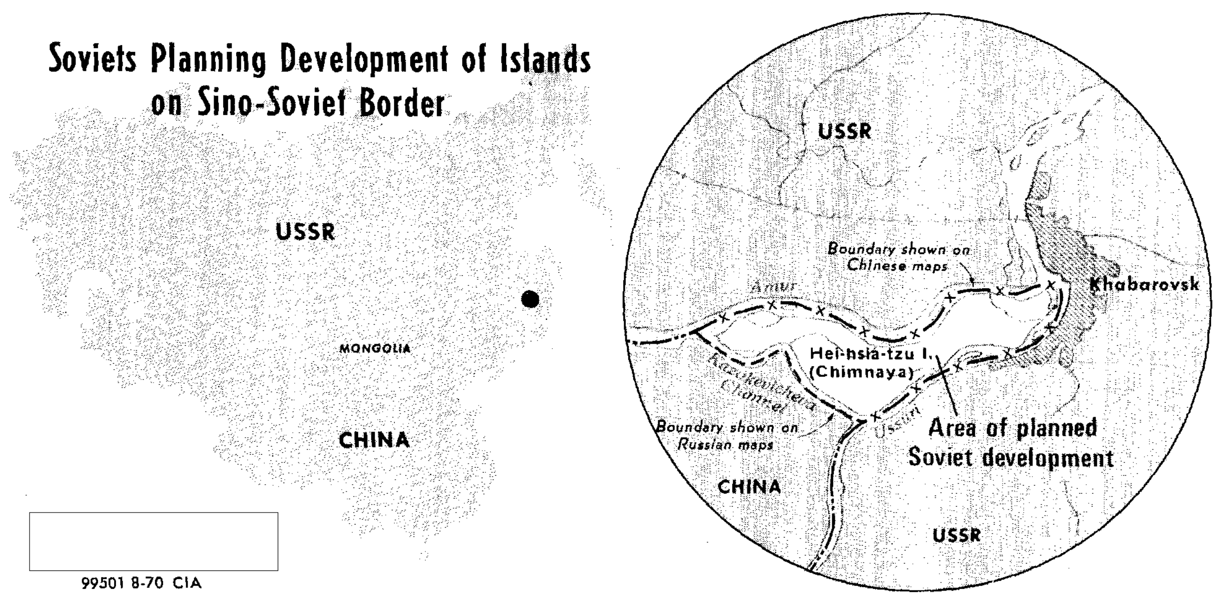
EUROPE

Sino-Soviet Relations

The Soviets are taking steps to bolster their claim to a highly sensitive section of the disputed Sino-Soviet border at a time when their relations with Peking are as sour as ever. A Soviet party newspaper reported on 2 August plans of Khabarovsk—the important Soviet Far Eastern city—for extensive agricultural development of two islands in the Ussuri River, which forms part of the Soviet-Manchurian frontier.

These islands are by far the most important of the more than 700 in the Amur and Ussuri that are subject to conflicting claims by Moscow and Peking. They amount to strips of land about 25 miles long at the Amur-Ussuri confluence, which dominates Khabarovsk. Soviet officials have stressed that they view this area as particularly critical because of its strategic location, and Moscow is clearly eager to consolidate its control. Development of the islands is billed innocently as merely a part of a program announced at the July central committee plenum to increase Siberia's self-sufficiency in food production. Nevertheless, Moscow privately recognizes that the Chinese have a good legal case based on international law to support their claim to the islands, and it evidently hopes that the island's development will enhance the shaky Soviet claim.

The Soviet leaders are aware that deliberately reviving this crucial frontier issue runs the risk of triggering loud protests from Peking, which may be provoked to mount its own "development" program for disputed border territory. In any event, the Soviet plan clearly underscores the lack of movement in the ten-month-old border negotiations and bodes ill for any progress in the future. A previous round of border talks in 1964 broke down, in part because of unresolved disputes over these islands. Until the appearance



25X1

of the newspaper article, both sides had carefully avoided public mention of the islands near Khabarovsk since the talks got under way last October.

Meanwhile, the widely rumored exchange of ambassadors between Moscow and Peking appears to have run into additional difficulties. Some rumors circulating in diplomatic circles in Moscow now allege that the Soviet nominee's departure for Peking has been further delayed because of "illness." Others claim that he has been successful in evading the assignment, which in effect would be diplomatic exile from Moscow politics, and that Moscow has selected a new candidate.

The impasse over the on-again-off-again ambassadorial exchange has been complemented by an upsurge in Soviet polemics against Peking . the form of reprints of East European diatribes. One recent article displayed an unusual degree of Soviet concern over China's nuclear-missile program, and other articles have warned that Peking is not to be trusted despite its adoption of a more moderate foreign policy posture.

For its part, Peking used the anniversary of the People's Liberation Army last week to focus attention on the Soviet military buildup. In particular, Peking charged that Moscow "greedily eyes" Chinese territory, but this probably does not reflect concern over immediate Soviet military intentions. Nevertheless, Moscow radio quickly responded by warning the Chinese that this kind of talk could "sabotage" the border negotiations. 25X1

♦ ♦ ♦

WEST EUROPEAN SPACE COOPERATION: The 13 members of the European Space Conference, meeting late last month in Brussels, agreed in principle to establish a "European NASA" to replace their existing multilateral space organizations and decided to send a delegation to Washington in the fall to discuss European participation in US space programs. This delegation will also explore the availability of US launchers for use with European satellites, but in the meantime the Europeans will proceed with their own launcher development programs. Although the conference meeting was generally an unexpected success, it was marred by several familiar problems. The UK said it needed more time before making any commitments; France reserved its position on the institutional arrangements for the new organization; and the UK, France, and Belgium all limited their financial contributions. 25X1

♦ ♦ ♦

ITALY: Premier Colombo's skillful negotiations in forming a new government have kept the center-left coalition alive, but underlying tensions remain. A prime factor in the fall of the previous cabinet was the disagreement between the militantly anti-Communist Unitary Socialists (PSU) and the orthodox Socialists (PSI) over the limits of cooperation with the Italian Communist Party, especially at the local government level. Colombo placated the PSU with a provision in his political platform that preference should be given to the formation of a center-left provincial coalition where possible. He pleased the PSI, however, with the stipulation that Socialist participation in the "leftist" coalitions with the Communists in some provinces is not to be taken as a "step backward" toward the discredited popular front. This permits the PSI to join with the Communists in several provinces where the four center-left parties do not have the votes to form a government. The other points in Colombo's program, as reported by the press, give him flexibility in dealing with the economic and labor problems facing Italy. His experience as minister of finance in eight previous cabinets will stand him in good stead. 25X1

♦ ♦ ♦

NATO: *Allies Consider Defense Burden-sharing*

The European Allies, urged on principally by the West Germans, are considering an annual multilateral contribution to ease the cost to the US of stationing its troops in Europe. The Allies apparently now believe that such an effort will be necessary to fend off sizable reductions in US combat forces there. They are not likely to find it easy, however, to settle on the size of the contribution and to distribute the burden among themselves, to say nothing of coming up with the necessary funds.

The Allies, who at first had hoped to prevent US reductions with a "token" contribution, now are convinced that more will be required. They are accordingly pressing for an indication of how large the contribution must be. The Germans have said that $1 billion—a figure frequently mentioned in the press and by some US Congressmen—would be unobtainable. They apparently are willing to assume a significant share of the cost, but want the offer to be multilateral to help them sell the plan domestically.

Not all the European members may be as willing or able as the Federal Republic, however, to manage their "share" of the cost, and too limited a participation by the other members would leave the scheme with a very flimsy multilateral cloak. The UK, which probably would be expected to pick up a share second only to Bonn's, already is emphasizing its own economic difficulties. The French to date have shown no interest in participating in the burden-sharing scheme, and the other European Allies apparently have not approached Paris on the question.

Expressions of strong opposition to any substantial change in US force levels have highlighted the early stages of the NATO study, known as AD-70, on Allied defense problems of the 1970s. The Europeans are worried that changes in the US commitment to NATO might be accompanied by movement away from the current alliance doctrine of flexible response and toward greater reliance on either tactical or strategic nuclear weapons. They are willing, however, to consider in the AD-70 study how the US could make modest cuts in noncombat areas, if some reductions were absolutely necessary, and the West Germans have indicated that they could accept a reduction in the US stockpiles in Europe presently available to support a conventional war for 90 days. The Germans and the others, however, are hoping that, in return for a multilateral financial contribution to the US, they will receive a US commitment to retain present combat force levels.

The Europeans hope to come up with a burden-sharing proposal at their next Eurogroup meeting, scheduled for 1 October. The defense ministers may also discuss then in more concrete terms some possibilities for intra-European defense cooperation, such as exchanges of information and cooperation in training, ideas they received favorably at the last Eurogroup session in June. 25X1

◆ ◆ ◆

Romania: *Independent Diplomatic Activity*

Since the signing of the Soviet-Romanian friendship treaty one month ago, Bucharest has undertaken diplomatic activities designed to show that it gave up none of its sovereignty to the Russians. The Romanians obviously believe that this helps to substantiate their claim that the treaty tacitly recognizes their country's special status within the Communist community and their policy of friendship with all parties and all nations regardless of social system.

Romanian officials are generally relieved that after a two-year delay the treaty is finally out of the way. In private they express the belief that Bucharest came off better than Moscow because the language of the treaty is more open-ended and flexible than that of the other East European treaties with the Soviet Union. Publicly neither the Romanians nor the Soviets have shown any sign of give on the fundamental issues that divide them, but the atmosphere appears to have improved marginally, especially in terms of bilateral economic cooperation.

The Romanians succeeded in balancing the impact of the treaty signing by sending Defense Minister Ionita on an extended tour of North Korea and Communist China at the end of July. By this dramatic gesture, the Romanians hoped to make clear their position that the treaty's Article 8, which binds them to come to the aid of the Soviet Union in case of attack by "any state or group of states," cannot be used to involve them in any Sino-Soviet confrontation. In his public statements in China, Ionita pointedly noted that under the Warsaw Pact, Romania is obligated to defend against "imperialist aggression in Europe."

Although the Romanian cautiously avoided strident anti-Soviet remarks, the Chinese were not so circumspect. They offered to support Bucharest's independence against unnamed "foreign intervention, control, and aggression"—obviously a reference to the Soviets.

The Romanians' balancing act also extended to Europe. Bucharest began a private campaign in June to promote a conference on Balkan cooperation, knowing that the Soviets could not publicly object because the friendship treaty contains a clause specifically blessing such efforts. The idea apparently received at least favorable lip service in most of the Balkan capitals except Belgrade. It was discussed there in several high-level sessions, probably including the private interview President Tito held in July with Emil Bodnaras, one of Ceausescu's right-hand men, but to no avail. Yugoslav Premier Ribicic, following a private visit to Romania last week, made it clear that the Yugoslavs consider Bucharest's initiative impractical.

The Romanians plan to continue their demonstrations of independence. Ceausescu reportedly plans to come to the US for the anniversary 25X1
session of the UN General Assembly, probably in October, and he is scheduled to make a state visit to Austria in September.

◆ ◆ ◆

Spain: *Government Faces Labor Unrest*

After an official ultimatum to strikers to return to work, the sudden subway strike in Madrid ended last week without violence, but a rising mood of labor militancy poses problems for the Spanish Government and the official syndicates.

The subway strike was called on 29 July to protest the lack of progress in negotiating a new collective-bargaining agreement with the privately owned subway company. The workers demanded that management allot for wage increases 50 percent of the revenue from the recently authorized subway fare increase. They want across-the-board raises of about $40 per month per worker, plus some fringe benefits. The company's offer just before the strike was a maximum of 25 percent of the increased revenue for wage increases.

The government moved immediately to deal with the strike before it got out of hand. When a deadline to return to work by early afternoon was ignored, the Cabinet, meeting in a rare emergency session, decreed that if the strikers did not return to work by the next morning they would be mobilized under military law as provided in a 1969 statute. This allows mobilization in labor disputes seriously affecting public order. After meeting all night with officials of the government labor syndicate, the subway workers agreed to go back to work. The situation has returned to normal, and wage contract negotiations are expected to resume.

Although the strike lasted only one day, the extent of worker participation and the impact upon the public made it one of the most effective demonstrations in recent times. By issuing a drastic ultimatum, the government was able to suppress the strike without using the police and risking a violent clash, such as occurred in Granada on 21 July when police fired on demonstrating construction workers, killing three of them.

There have been a number of strikes and labor disputes this year, largely from economic causes. Some 4,000 bargaining agreements expire and must be renegotiated. Workers are becoming more militant in pressing for higher wages in the face of steadily rising prices. They are also dissatisfied with the cumbersome official syndicate system, which tends to favor employers and drags out negotiations until workers lose patience. Workers are being encouraged in their militancy by the illegal labor organization known as the Workers Committees, as well as by Catholic labor groups and some Catholic priests.

The Spanish Government is in the process of reorganizing the official syndicates, but the reform law has become bogged down in the Cortes while a tug of war goes on over more autonomy for workers. The present demonstrations strengthen the hand of those who do not want liberalization, yet further demonstrations are likely if the workers are disappointed in the reform law.

In an effort to maintain labor peace, the government may permit generous wage increases exceeding its guidelines of eight percent, but this would have a serious impact on the economy. [redacted] 25X1

♦ ♦ ♦

ARMS CONTROL: Prospects for the US-USSR draft seabeds treaty have improved as a result of the agreement of the superpowers' delegates at the Geneva disarmament talks on changes designed to satisfy most criticisms of the present text. It now appears likely that Argentina and Brazil, whose opposition could have produced a refusal by the Latin American bloc to support the treaty, will endorse it in its altered form, which is being referred to the capitals. Failure to reach agreement on the treaty at the current talks would increase pressure within the UN General Assembly to question the adequacy of the Geneva forum and to launch a more heated debate on maritime issues than now appears in the offing. [redacted] 25X1

♦ ♦ ♦

East Germany: *Harsh Weather Magnifies Economic Problems*

The East German economy has been hurt by the very cold and wet winter of 1969-70, the longest of the century. The effects will fall principally on the nation's balance of payments and on the East German consumer. The impact on over-all growth will be less serious, with a probable one half to one percent drop in national income and shortfalls in agricultural products, brown coal, and transportation and communications services.

During the past winter, coal reserves for both industrial and popular consumption, already short as an aftereffect of the hard winter of 1968-69, were further depleted and consumer discontent rose significantly. The tight food-supply situation, a result of the summer's drought, also deteriorated. Grain output, which declined 12 percent in 1969, may drop again this year.

Unwilling to face the political consequences of a large fall in consumption, the leaders have announced an $80-million increase in the purchase of foodstuffs in the West, as well as additional imports from the USSR. Imports of grain and high-protein feed supplements may rise by as much as 500,000 tons in 1970. Bituminous coal imports also will have to be increased sharply to make up for the lack of domestic brown coal. The regime is campaigning to increase exports to minimize the resulting trade deficit, but the serious balance-of-payments situation will worsen.

The effects of increased imports probably will be felt most sharply in the balance of trade with West Germany, which is handled more or less on a barter basis. Interzonal trade has traditionally been used to fill emergency needs, because East Germany can run up substantial negative trade balances without having to settle with cash transfers. Imports, which rose during 1969 by almost 60 percent above 1968, continued to grow at a rate of 42 percent during the first four months of 1970 compared with the same period of the preceding year. A recent report indicates that East Germany's total indebtedness to West Germany now exceeds $545 million, in addition to a considerable indebtedness to other Western countries.

Although the problems caused by a single severe winter generally are manageable, the effects in East Germany have been magnified by the regime's determination to push economic growth at rates ambitious even under favorable conditions. Major plan indexes, especially for agriculture, had been unfulfilled in 1969, also because of bad weather. Nevertheless, the leaders did not reduce goals in the 1970 plan, and those for agricultural products and foodstuffs, construction, national income, and most types of industrial output were actually increased.

Failure to achieve these goals may have an effect on the targets to be set in the 1971-75 plan, which is still under discussion. Current drafts apparently again provide for unrealistically high goals for growth and leave only a minimum margin of reserves for any sort of emergency. The effects of the hard winter of 1969-70 could force reconsideration of the long-term plan and adoption of more realistic growth rates, thus easing pressure on the East German planners to ensure fulfillment of unrealistic goals. At the moment, however, this seems unlikely.

25X1

♦ ♦ ♦

USSR - West Germany: *Treaty Negotiations*

Soviet and West German negotiators continued intensive efforts this week to complete treaty negotiations. The daily meetings between Foreign Ministers Gromyko and Scheel since 27 July indicate that the Soviets have assigned a high priority to completing the talks. At the same time, textual changes the West Germans have sought to incorporate in the draft treaty have encountered Soviet opposition.

Early this week, the Soviets flatly refused to make changes of substance in the treaty. [redacted] 25X1

25X1

Nevertheless, the Soviets have taken cognizance of the Bonn government's need for some semblance of alteration that would accommodate German interests and help to overcome domestic opposition to the treaty. They have been receptive to nonessential changes in the treaty, such as the addition of language that could be interpreted by the West Germans as an acknowledgment of their position but would still be vague enough not to constitute an explicit commitment by Moscow. Moreover, the Soviets have agreed to a complex system of subsidiary protocols that would be exchanged between the two sides at the signing of the treaty.

The Germans acknowledge the toughness of the Soviet position but claim that progress has been made in defining the problems and resolving some of them. Such gains, however small, provide some assistance to Bonn in its efforts to sell the treaty domestically. The issue is whether they will be enough or whether it will be necessary, in the face of "sellout" charges from the opposition, for the Brandt coalition to ask Moscow for more. Any agreements that Scheel brings back will be subjected to close scrutiny and to intensive parliamentary debate. Meanwhile, government forces have restated their resolve to withhold implementation of an accord pending satisfactory conclusion of the four-power talks on Berlin.

The East German press has continued to treat the Scheel-Gromyko talks cautiously, confining coverage to the replay of TASS reports and brief items noting the contention of "forces" for and against agreement in the Federal Republic. [redacted] 25X1

♦ ♦ ♦

UN-SEABEDS: The US proposal to create an International Seabed Resource Authority to govern exploitation of the ocean floor beyond a water depth of 200 meters received most of the attention at the meetings this week of the UN General Assembly's seabeds committee. Most delegations appreciated the US initiative, although the representative of Chile maintains that it discriminates against countries with little or no continental margin. The Soviets, who have consistently opposed the creation of such international machinery, indicated in their opening address to the committee that they now may be more willing to accept some sort of international agency. [redacted] 25X1

♦ ♦ ♦

Middle East: *The Pace of Peace*

Both Arab and Israeli ranks have been splintered by the acceptance of the US peace plan, but the Soviets have pitched in to help Cairo marshal support.

Moscow Backs Egypt's Stand

The Soviets have gone to considerable lengths to demonstrate their approval of Nasir's acceptance of the US initiative and to quiet Arab critics of his stand. Moscow's strong support was almost certainly promised during Nasir's recent visit to the USSR, probably in return for his agreement to Soviet recommendations that he respond favorably to the US plan.

The USSR will probably take advantage of the presence of a high-level Iraqi delegation in Moscow to put pressure on Baghdad, which has been vehemently critical of the Egyptian and Jordanian acceptance. The Soviets probably hold no hope of lining up Iraqi support for Nasir, but they will try at least to soften Baghdad's public opposition by pointing to Soviet economic and military aid programs to Iraq.

25X1 [redacted]

The Soviet leaders may think that there is now at least a small chance to gain a settlement in the Middle East on terms generally favorable to the Arabs. Even if no settlement is forthcoming, however, the Russians may be hoping for the further diplomatic isolation of Israel and for an even greater Arab hostility toward the US. Nevertheless, the Soviets probably foresee success for these aims only if the Arabs play their cards carefully and if hotheaded elements do not undermine Soviet-Egyptian maneuvering.

"Meanwhile, the Arabs Are Discussing the Peace Proposals Among Themselves"

Arab Bickering Continues

A conference of Arab foreign and defense ministers—including representatives from Libya, Egypt, the Sudan, Jordan, and Syria—convened in Tripoli on 5 August. Originally slated to open three days earlier, the conference was postponed to give Libyan Prime Minister Qaddafi a chance to persuade Iraq to participate. His visit to Baghdad was unsuccessful, however, and on the eve of the conference Baghdad Radio continued its scathing attacks on Nasir and his policies. Algeria joined Iraq in boycotting the meeting.

25X6

The precise purpose of the conference is not clear. Egypt's semiofficial newspaper *Al Ahram* has said that the talks will be concerned with ways to bolster the "eastern front" against Israel, and that Egypt does not intend to discuss its acceptance of the US proposals. The participants, however, will almost certainly attempt to hammer out some kind of joint strategy in the light of the prospective cease-fire and negotiations.

Some of the states endorsing Egypt's acceptance have adopted a more forthcoming attitude toward the fedayeen than has Cairo. On 4 August, the Libyan Revolutionary Command Council issued a somewhat inconsistent statement ruling out negotiations, peace, or recognition of Israel, but announcing full support for Egypt and denouncing all attacks on Nasir. Libya also promised that it would continue to supply funds and arms to the Palestine liberation movement led by Fatah as long as it pursued the "true road" of fedayeen action.

The Sudan's policy has also been somewhat ambiguous. Khartoum, in line with its pro-Nasirist orientation, promptly endorsed Egypt's acceptance of the US plan, but it has announced that representatives of the Palestinian movement will be allowed to use Sudanese radio facilities. President Numayri almost certainly checked this move with Nasir, however, because the Sudan is too heavily dependent on Egyptian support to fly in the face of Cairo's wishes. Nasir may want to provide the more moderate fedayeen elements with a propaganda outlet to counter the attacks against him emitting from Iraq. At the same time, his refusal to allow the fedayeen to broadcast from Egypt enables him to give the appearance of full backing to the peace initiative.

25X6

25X6

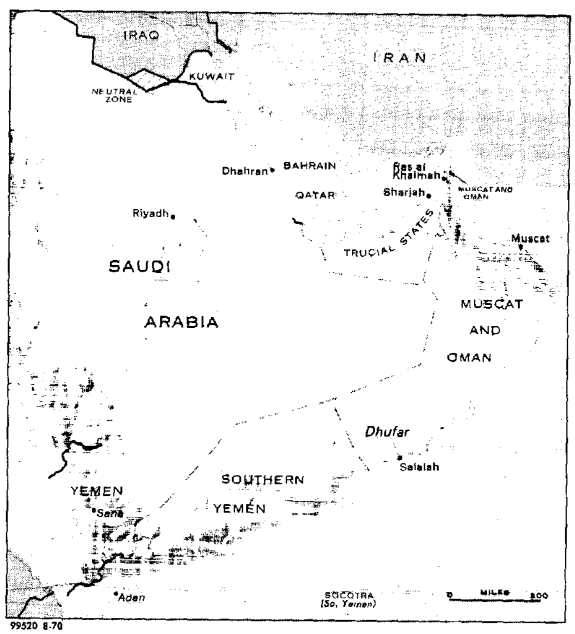
25X6

The UN Climbs Aboard

At the UN this week, Secretary General Thant's special envoy Gunnar Jarring began intensive consultations with the parties in the Middle East, representatives of the Big Four, and UN officials. Jarring appears determined to initiate indirect talks quickly. He also hopes to emphasize "quiet diplomacy" to head off speculation on the course of the negotiations and the terms of a settlement. UN Truce Supervision Organization (UNTSO) chief Sulasvuo has returned to the Middle East after discussions with U Thant and presumably is canvassing the Arabs and the Israelis as to what UNTSO might contribute to the policing of a cease-fire arrangement.

25X1

Internal Unrest in the Persian Gulf



The recent coup in Muscat is dramatic evidence that important changes of regime can take place in eastern Arabia with little warning. As the British withdrawal from the Persian Gulf approaches, the fragility of the numerous small states in the area and their increasing oil wealth seem certain to lead to more internal instability. The present trend toward maintaining armies and security forces largely officered and commanded by British personnel may slow the growing dissidence, but eventually the dependence upon foreign personnel probably will result in greater support for subversive groups.

The coup in Muscat may prove to be an unsuccessful palliative to the situation there, as the young sultan is a moderate dealing with radical forces. Since 1932 the old sultan had made little effort to move his government out of the 15th century, even after he obtained considerable revenues from oil. The sultan's miserliness combined with his general unpopularity encouraged local dissidents to increase their active guerrilla campaign against him.

In Dhufar Province, where the sultan had resided for years in order to avoid the more dangerous environment of Muscat, the local dissidence grew into a more broadly based organization; the Dhufar Liberation Front, with perhaps 600 men, then became the National Democratic Front for the Liberation of Oman and the Arabian Gulf (NDFLOAG). It appears to be an umbrella organization, comprising other Omani dissidents as well as Baathi and Communist elements operating in the Trucial States.

In the area as a whole, subversive incidents are becoming more frequent: last month an amateurish attempt was made to assassinate the ruler of Sharjah, small shipments of arms are moving into Ras al-Khaimah, and Southern Yemeni laborers are trying to infiltrate the Persian Gulf states. The NDFLOAG apparently hopes to coordinate such activities and thus become capable of overthrowing all the autocratic rulers in the area. [redacted] 25X1

25X1 So far the results, including mining incidents, mortar attacks, and propaganda leaflets, have been more annoying than serious.

The sheiks and rulers still seem too bound up in their own maneuverings for power to consider seriously methods for dealing with local subversion. They continue to rely upon repressive security measures that grow steadily more out of date. [redacted] 25X1

♦ ♦ ♦

MOROCCO: The government will probably win another landslide victory in the parliamentary elections scheduled for 21 and 28 August. A newly formed coalition of opposition parties, the National Front, announced at mid-week its intention to boycott the elections, but the coalition is made up of political groups torn by internal divisions and its leaders are mutually suspicious. They have declared that they will repudiate any candidates running under their party labels, and have denounced the future parliament as "an instrument fashioned to exploit and repress people behind the facade of a false democracy." The King, apparently rankled by the refusal of the opposition to collaborate on his terms, has publicly and strongly criticized it for a "selfish quest" for power. He also warned that "libelous criticism" would be severely punished, suggesting that press controls—relaxed during July's referendum campaign—may soon be reimposed. [redacted] 25X1

♦ ♦ ♦

WESTERN HEMISPHERE

Kidnapings in Uruguay

The first kidnaping of foreign officials in Uruguay has intensified the struggle between the terrorists and the government and probably signals a higher level of violence in the future.

Coordinated attacks on 31 July netted the extreme leftist Tupamaros a wounded American AID official and the Brazilian first secretary. Two other American Embassy officers and the minister of public works escaped capture. For the release of the two foreigners the Tupamaros have demanded the release of all political prisoners, including about 150 Tupamaros. The judge who sentenced many of these Tupamaros to prison was kidnaped on 28 July, interrogated, and released unharmed on 4 August.

The terrorists have given the government until 7 August to agree to the ransom. If President Pacheco continues to reject the demand, as it appears he will, the Tupamaros have threatened to "pronounce sentence."

President Pacheco's initial rejection of the ransom demand is in line with his oft-repeated policy of not dealing with kidnapers. Pacheco is also under pressure from military leaders not to accede to the terrorists' demands. In the week

Uruguayan authorities arresting a Tupamaro during a shootout last year

since the kidnaping, there has been no direct contact between the government and the Tupamaros. Although the Papal Nuncio has offered to serve as an intermediary, the impasse appears to be solidifying.

The Tupamaros have clearly demonstrated that they retain the initiative in what is now a state of urban guerrilla warfare. They probably will continue their campaign to discredit the government and provoke the military, perhaps in conjunction with Pacheco, into ending democracy in Uruguay. 25X1

♦ ♦ ♦

CHILE: It seems unlikely that any of the three candidates will receive a majority of the popular vote in the presidential election on 4 September. In such a case, a runoff vote will be required for the two top contenders in a meeting of both houses of the Congress on 24 October, only eleven days before the inauguration. If a quorum of 101 legislators, a majority of the congressional membership, is not present on that date, any number that showed up the following day could decide the election. The governing Christian Democrats' candidate still appears to be running third. Their congressional representation is the largest, however, and some Christian Democratic votes would be required if Congress had to decide between conservative Jorge Alessandri and Marxist Salvador Allende. 25X1

♦ ♦ ♦

Peru Announces Radical Industrial Reform Decree

President Velasco's long-awaited industrial decree, which calls for profit sharing and state or worker ownership in all manufacturing enterprises, will worsen the depressed business climate. Some businessmen have expressed fear that it may spell the eventual end of private enterprise in Peru.

The decree reserves all new heavy industry to the state and requires foreign firms to conclude with the government contracts setting timetables for reducing their present equities. Foreigners may retain only 33 percent ownership if the company now is wholly foreign owned, but they may retain 49 percent if it is a joint venture. Majority ownership presumably would be acquired by the state.

The decree also provides for the distribution of ten percent of each firm's pre-tax profits to the workers and another 15 percent to a newly established "industrial community fund." In basic industries, which are to be largely state owned, the fund will invest in bonds and will distribute the interest to the workers. In most private firms this fund would gradually buy the company's shares and turn them over to an employees' cooperative after 50 percent interest is obtained. It is not clear, however, whether workers are to acquire shares in foreign-owned firms. Workers are to participate in management to the extent that they or the "industrial community" has ownership.

Tax concessions and other inducements for investment, however, are included to reduce the negative impact of the new law. Taxes have been lowered for firms locating outside the Lima-Callao area, and liberal tax concessions are to be given firms making new investments before 1973. In addition, high-priority industries have been granted import duty concessions to a varying degree and are to receive liberal credit from state banks to finance expansions.

There had been some expectation in the business community that the final decree would incorporate suggestions by local businessmen and would be more moderate than a preliminary draft that had been circulated. Many businessmen thus were shocked to find the decree more radical. Although business reaction has been relatively cautious thus far, the National Society of Industry (SNI) has issued a communiqué of "constructive criticism." The SNI states that private enterprise appears to be on the way out in Peru and points out that even the worker will not benefit as much as claimed because he will lose his non-transferable shares upon leaving his job. The more conservative press has voiced concern about the new reform's effect on foreign investment and on the nation's economy. 25X1

♦ ♦ ♦

ARGENTINA: Guerrillas seem to be changing their emphasis from bank robberies and raids on small security posts to larger, coordinated attacks on several installations simultaneously. Last month terrorists took over a small town briefly, seizing the police station, telephone exchange, and railroad station and—after cutting all communications in the area—robbing a local bank. Several weeks before a similar raid had been carried out in another town. The terrorists describe themselves as members of the Revolutionary Armed Forces, and the slogans they have painted on walls suggest that the group is linked with the left-wing Peronist Armed Forces. 25X1

♦ ♦ ♦

Bolivia: *Political Twists and Turns*

President Ovando appears to have strengthened his position during the past week, but his conflict with top military leaders has not yet been resolved. Ovando now has received the resignations of the entire cabinet, although it is not yet clear how many he will accept.

The collective cabinet resignation came the night of 3 August after the commanders of the three services reportedly decided to overthrow Ovando. The morning press had carried a surprisingly accurate account of the coup plans, which were promptly denied by those named as leaders. By midafternoon Ovando was meeting with second-echelon commanders at his home where General Torres—the former armed forces chief who was recently forced out of his post by the opposition of army commander General Miranda—had sought refuge to avoid arrest. Later that day the President met with labor leaders, who, he claims, expressed their support for his government.

Bolivia

While Ovando was lining up his backers, the three armed services commanders were in session with Interior Minister Ayoroa and other military members of the cabinet. Then, in the early morning hours, came a series of strange announcements. First Ovando announced that he had presented his resignation to the armed forces but it had been rejected. This was followed ten minutes later by Ayoroa's announced resignation and an hour later by that of the entire cabinet.

The net effect of the moves and countermoves is that Ovando remains in office strengthened somewhat by the cabinet's resignation. The armed forces leaders have missed what seemed to be their best chance to remove him and may now have lost significant support among lower echelons in the armed forces.

Nevertheless, army commander Miranda and the other two service chiefs remain in their posts and might still be prompted to act if Ovando completely ignores their wishes in naming his new cabinet. Furthermore, the President's soft line toward the guerrillas—the press reports that he has gone so far as to suggest a possible truce—might have the effect of healing the divisions in the armed forces and creating solid opposition to him.

Since the raid on a US mining company north of La Paz on 19 July, the pro-Castro guerrillas of the Army of National Liberation (ELN) have managed to elude the army but have done little else. So far there have been two skirmishes between the ELN and the army units pursuing them through hostile jungle territory, which resulted in the death of at least eight guerrillas and one soldier and the wounding of several others.

The military's strong concern over the possible spread of guerrilla operations, combined with bolstered self-confidence as a result of successes so far, is likely to prompt a rather strong rejection of President Ovando's conciliatory moves toward the guerrillas. Whether this will be sufficient to overcome the high command's apparent distaste for a move against Ovando when all the odds are not on its side remains to be seen. [redacted] 25X1

* * *

Colombia: *Policies of the New Government*

The inauguration on 7 August of Misael Pastrana as president of Colombia may be marred by minor disturbances, but there is little likelihood of a serious disruption of the ceremony. Any disturbances, however, will be the least of the new President's worries during his four-year term.

Pastrana was elected last April with a razor-thin plurality, and he lacks a majority in Congress. He has little political experience and has given no indication of vigorous leadership. He will, however, inherit an improved economy, he will be able to dispense patronage, and he can, if he considers it necessary, constitutionally ignore Congress and rule by decree. On balance, it appears that Pastrana will have an undistinguished and sometimes stormy term but that he will be able to complete his four years as president.

The new government probably to a large extent will continue the policies of the old—Pastrana was President Lleras' handpicked can-
25X1 didate. [redacted] the incoming president hopes to expand trade with the Soviet Union and Eastern European countries, to gain tighter control of Colombia's international credit machinery, to seek improved relations with the United States Senate Foreign Relations Committee, to reduce the budget of the Agrarian Reform Institute, to curtail waste and corruption in the Industrial Development Institute, and to seek support in Congress for the nationalization of the transportation industry.

In the absence of any clear indication of new policy directives, however, it is likely that many of his decisions will be the result of ad hoc reactions to situations. In his efforts to win political support for his administration, Pastrana has attempted to make bargains with numerous politicians, and such tactical efforts probably will characterize his presidency. [redacted] 25X1

President Misael Pastrana

* * *

Caribbean: *Problems for Black Governments*

Political leaders in the Caribbean area are displaying increased sensitivity to a variety of racial and nationalistic issues.

Recent statements by the prime ministers of Guyana, Barbados, and Jamaica condemning the possibility that the UK will sell maritime defense equipment to South Africa are probably due in part to the popular domestic appeal of a militant stand against South Africa's racial policies. Prime Minister Burnham of Guyana objected to the sale on the grounds that the arms would be used to suppress African "patriots" rather than for national defense. Burnham, however, probably was bluffing when he threatened to take Guyana out of the British Commonwealth if the deal is consummated.

Prime Minister Barrow of Barbados also attacked the UK's plans and in effect warned that "it might be time to have a Commonwealth without the British" if they persisted against the opposition of other Commonwealth countries. Jamaica's Prime Minister Shearer has also denounced the arms deal. In addition to their domestic aims, Shearer and Burnham probably are preparing the groundwork for their attendance at the Conference of Nonaligned Countries to be held in September in Lusaka, where they will be competing with each other for the role of spokesman for the Caribbean region.

Burnham is having his own racial problems at home. His efforts to put the pressure on the local bauxite industry to allow the government more "meaningful participation" in that industry gave the African Society for Cultural Relations with Independent Africa (ASCRIA)—the major black power group in Guyana—the opportunity to demonstrate its strength. ASCRIA, presumably with government approval, took part in a labor dispute against a Canadian mining company but unexpectedly took advantage of the occasion to attack the government and officials of the Guyana Mine Workers Union (GMWU), apparently in the hope of influencing upcoming union elections. ASCRIA's attack led the government to rebuke ASCRIA publicly for its overzealous actions.

Prime Minister Pindling of the Bahamas also has experienced troubles of a racial nature at home. Visiting Jamaican professor Trevor Munroe, at a seminar of a radical Bahamian youth organization in Nassau in late July, delivered emotion-charged speeches citing the need for a revolutionary black-power movement throughout the Caribbean and calling on the Bahamians to become more active toward this goal. Munroe also urged the expulsion of the economic influence of "white imperialists" and the destruction of governments that manifested the same values and objectives as those of "imperialist powers." Although Pindling later said that he "took strong exception" to some of Munroe's ideas, he was eager to reaffirm his government's interest in the youth of the Bahamas and tried to give as little offense to them as possible. 25X1

♦ ♦ ♦

CUBA - TRINIDAD AND TOBAGO: Havana is continuing to develop contacts with other Caribbean countries. A six- or seven-man delegation from Cuba will travel to Trinidad-Tobago in mid-August for an undetermined stay, reportedly for talks that will deal primarily with agricultural and industrial development. A similar group from Cuba traveled to Trinidad-Tobago last December, and a delegation from Port of Spain repaid the Cuban visit with one to Havana during February. 25X1

♦ ♦ ♦

25X1

BAHAMAS: US plans to dispose of obsolete nerve gas in the Atlantic have met with objections from the governments of the Bahamas and Bermuda. Both Commonwealth members have asked the British to intercede on their behalf in seeking a postponement until a team of British experts examines the safety considerations being taken to ensure there will be no contamination of the surrounding land areas. The proposed dumping grounds are located about 170 miles from the Bahamas and about 280 miles from Bermuda. The US and British are collaborating in an effort to reassure government leaders of the safety features of the project.

25X1

25X1

Panama: *Preparation for Treaty Negotiations*

General Torrijos appears to be strengthening his already tight grip on Panamanian political life, probably in order to protect his flank while devoting increased attention to outstanding issues with the US.

Torrijos this week instituted a number of changes in the top ranks of the National Guard in an effort to strengthen his personal control. For example, he promoted Major Manueal Noriega, the Zone commander who facilitated Torrijos' return to Panama during the coup attempt last December, and appointed him to the General Staff. At the same time he retired another General Staff officer who had stood up to him on questions of fiscal responsibility within the Guard.

Torrijos has also moved to extend the government's control over all newspapers published in Panama. The publisher of the prestigious *La Estrella de Panama* and its English-language counterpart was forced out, and the new publisher has wasted little time in adopting an editorial policy favorable to the government.

Torrijos Ponders Guard Changes

Using the carrot as well as the stick, Torrijos reportedly announced on Tuesday a general pardon for all political prisoners in the country. Panamanian security forces have been effective in keeping opposition elements off balance, and this is a move from strength rather than weakness. Torrijos can thus win political points without any sacrifice of political control.

Despite these domestic moves, Torrijos' attention has been increasingly focused on relations with the US, with the issue of Rio Hato, a large US military installation outside the Canal Zone, assuming particular importance. Torrijos apparently has backed away from an earlier oral commitment to General Westmoreland to extend the base agreement, which expires on 23 August unconditionally. He recently told a student delegation that he would demand that the US give Old France Field to Panama for the purpose of enlarging the Colon Free Zone as the price for continued US use of Rio Hato. He has also alluded to an increased sugar quota and construction of a highway. Torrijos, however, has not outlined a formal position and may be using the Rio Hato issue as a testing ground for tactics that might be used against the US during Canal Treaty negotiations.

Although Torrijos has alleged that his tougher stance on Rio Hato stems from student pressure, student and popular interest in either Rio Hato or Canal Treaty negotiations appears nearly nonexistent at present. Torrijos seems to be trying to manipulate the students for his own purposes. In April, for example, a Torrijos youth group was organized in Panama City, and this organization might form the nucleus for progovernment demonstrations. 25X1

◆ ◆ ◆

Page Denied

Secret

25X1

DIRECTORATE OF INTELLIGENCE

WEEKLY SUMMARY

Special Report

The European Communities: A Monetary Union

Secret

№ 43

7 August 1970
No. 0382/70A

Page Denied

25X1

THE EUROPEAN COMMUNITIES: A MONETARY UNION

Developing the European Communities (EC) into a true economic and monetary union is likely to be the major internal preoccupation of the Community membership for the next decade—and probably well beyond. With the national economies of the member states increasingly interdependent as a result of the customs union, the common agricultural policy, and other measures the Common Market has put into effect, all the member states recognize the need for at least a greater measure of coordination of fiscal, monetary, and budgetary policies at the Community level. Otherwise, trade and capital flows will be disrupted by restrictive measures reimposed at the national level whenever a balance-of-payments crisis threatens.

Some of the elements of a future economic and monetary union are already in place, such as the agreement on a common system for certain indirect taxes, the small but growing Community budget, and a great variety of arrangements for monitoring and discussing national economic trends. In the past few months, moreover, the member states appear to have made some headway toward agreement on the broad outlines of a staged program which—beginning with harmonization of national economic policies—would move toward Community-determined policies and perhaps ultimately toward a single currency. Nevertheless, the technical problems involved are formidable, and basic differences in economic philosophies are far from reconciled. Some of the member states continue in fact to believe that, as long as national policies and economic structures remain so different, a too hasty institution of common rules or measures—such as denying the member states the right to resort to exchange controls—would aggravate rather than prevent crises. The basic question involved in bringing about uniform management of economic and monetary policies, of course, is the fundamental, political one of how much power member states are willing to transfer to Community institutions, and how fast.

Under the best of circumstances, this next stage in the evolution of the Common Market will probably be no less difficult or contentious than the transitional period that was completed last January. But—to the members, the candidates for membership, and the other participants in the international monetary system—it will be more important. The question has already been raised of how to relate the Community's current deliberations to the monetary problems that will be posed in a year or so by Britain's prospective accession. Whether new ways can be found to improve the functioning of the international monetary system will depend in good part on the Community's success in consolidating a stable monetary system of its own.

The Hague Communiqué

The impetus for the present discussion of monetary union arose largely from the agreement reached last December at the "summit" conference of the Six at The Hague to "relaunch" the Communities. The basic elements of that agreement were to accelerate decisions on internal policies and to open negotiations for enlargement. As part of the internal program, the member states recorded their intention, as stated in The Hague communiqué, to develop during the course of 1970 "a plan to be carried out in phases...with the purpose of achieving an economic and monetary union." It was further stated that the "development of monetary cooperation should be based on the harmonization of economic policy." In addition, it was decided "to have investigated the possibility of creation of a European reserve fund which should flow from a common economic and monetary policy."

Monetary Union

What does monetary union mean: Unrestricted and irrevocable freedom of money and capital movements among the participating states, exchange of the member currencies among each other at fixed and unchangeable rates, pooling and joint administration of the foreign exchange reserves, unrestricted operations of all credit and finance institutes in the area of the Community as a whole. Such a monetary union can be kept free of tensions and crises only if aggregate demand in the individual member states were to develop parallel (that means at the same growth rhythm relative to the real growth potential prevailing in the individual member states). Not only credit creation by the local banking systems, but also public spending, as well as wage and other income developments in the economy, would have to be subjected to this parallelness.

—From speech by West German Bundesbank Vice President Otmar Emminger in Bad Godesberg in April 1970

* * *

Economic and monetary union will permit the realization of an area within which goods and services, people and capital will circulate freely and without distortions of competition—without giving rise at the same time to structural or regional imbalances.

—From the Interim Report to the Werner Group to the Council and Commission, May 1970

Background

The monetary objectives adopted at The Hague meeting reflect a Community history of difficulty in coping with balance-of-payments crises. Existing Community mechanisms have thus far lacked both the speed and the resources to deal with losses of reserves resulting from prolonged deficits or sudden speculative runs. The Treaty of Rome makes provision for mutual aid, but the relevant clause—Article 108—proved insufficient as early as 1964 to deal with the payments crisis that developed the same year in Italy. While the Council of Ministers was still debating procedures and conditions for providing aid, the US came to Italy's rescue. Again in 1968, it was international aid, this time from the Group of Ten meeting in Bonn, that met the threat to the French franc resulting from the unprecedented flight from it to German marks and Swiss francs.

With aid available through international arrangements such as that provided by the Group of Ten and the so-called Basle Club of central bankers, the need for credit arrangements within the EC as such has been questioned. Indeed, until recently the view has prevailed among the Six that discussion and examination of monetary and financial policies within the Community would be sufficient to maintain equilibrium, and a host of committees have devoted themselves to this task in the past decade.

The 1968 crisis, however, brought home the disruptive potential of crises arising from sudden and large speculative capital flows—originating in this case predominantly from within the Community itself. Although supplementary aid from extra-EC sources might always be needed,

Existing Monetary Arrangements in the Community

Budgetary, monetary and credit policies are made through independent decisions by the competent national authorities–treasuries and central banks–and the organs of the Community have little opportunity to intervene. In other words, while it is true that the economic policies are subject to a considerable effort of coordination, it is also true that this process is limited to marginal adjustments. These are designed to make allowance to some degree for the interests of the other member nations without, however, impinging on the policy-making process which takes place essentially on a national scale.

The very provision of the Rome Treaty that each member nation is required to regard its exchange-rate policy as a problem of common interest translates itself in practice into a prior consultation–when it takes place at all–on a parity change decision which has already been made by the national authorities. The countries of the Community are not yet accustomed to discuss the consistency and validity of the existing parities. There has never been a Community consultation, at least on a political level, about the adequacy of the exchange rate of a member country's currency, even when the phenomenon of apparent disequilibrium in the exchange rate existed over a long period of time.

–From remarks by Italian Treasury Minister Emilio Colombo at a meeting of EC finance ministers and central-bank governors in February 1970

* * *

The first two medium-term programs did not generate sufficiently harmonized objectives–a basic condition of effective coordination. Examinations of the short-term situation in the Community have often ended only with recommendations formulated in completely general terms, even when the Community interest would have called for adopting more concrete positions. In general, the consultation procedures have not given the hoped-for results, either because they assumed a purely formal character, or because the member states protected themselves by resorting to escape clauses.

–From the Interim Report of the Werner Group to the Council and Commission, May 1970

Community authorities became convinced that if European integration were to be taken seriously, divergent policies within the Community as a cause of payments crises would have to be taken into account, and some sort of effective support mechanism would have to be developed to give expression to Community responsibility in the future.

Meanwhile, the member states became increasingly conscious that the growing interdependence of their economies meant that the Community as a whole would be more and more susceptible in the future to economic imbalances in one of the member countries. As demonstrated in the monetary crisis of 1968 and the German and French exchange-rate adjustments of 1969, such events can, in the words of a report done for the EC Council in May 1970, "seriously compromise the integration achieved in the fields of freeing movement of goods, services, and capital. This goes particularly for the common agricultural market." It can be argued that temporary restrictions on goods and capital movements do not seriously affect the long-term development of the Common Market, but such measures undoubtedly create a poor psychological climate in which to move forward. This is especially the case when the exceptional measures are not planned emergency procedures but rather are expedients adopted by the member governments and ratified at the Community level after the fact.

Moreover, the possibility of resorting to such expedients has gradually declined as the Community has developed. The growing interpenetration of the economies of the Six has weakened the autonomy of national short-term policies. For example, with trade accounting for an ever-greater proportion of national income in all the Six, national borders are no barrier to inflation. Thus some of the anti-inflationary tools normally used by national governments—such as credit restrictions—can be used by the Community members but with less effect. At the same time, these tools have not been given over even in part to the Community to enable it to deal with Community-wide disequilibrium.

Still other considerations have inspired increased Community interest in economic and monetary union. Some within the Community have been motivated to support it by a sort of "nationalistic" spirit—for example, as the most effective way of furthering a Community "economic personality" vis-a-vis the world in general and the US in particular. A Community "identity" would presumably be able to deal more effectively with the problems posed by "multinational" companies, uncontrolled "Euro-" markets in dollars and securities, and speculative movements of international capital. All of these postwar phenomena have their positive sides, but they also involve a certain loss of control by the Community members over economic trends.

Finally, some of the present interest in pushing the Common Market into a further stage of integration stems from the purely political objectives that motivated the Community founders in the first place. Economic and monetary union is seen as a way of creating new links between the EC members to supplement the cohesive effect of past measures that for various reasons may not be so binding in the future. In a recent interview, for example, Raymond Barre, the EC Commission vice president responsible for economic and financial affairs, cited the tariff reductions resulting from the Dillon and Kennedy Rounds, the prospective enlargement of the Community, possible tariff reductions with regard to Eastern Europe, and continued high US investments in the EC as developments that have lessened or will lessen the importance of the Community's external tariff wall. Hence, in his view, it is politically essential to find new ways to knit the Community together.

New Commission President on Economic and Monetary Union

No one can deny the purely political character of an undertaking on such a broad scale. No one can believe that such an important political problem can be solved simply by using more or less sophisticated techniques and simply by mobilizing forces belonging to the national and Community administrative bodies. To be achieved, a political objective requires a strategy capable of mobilizing, to as large an extent as possible, the national parliaments, the trends of opinion, the parties, and the trade unions.

--From speech by Franco Maria Malfatti to the European Parliament, July 1970

Commission Initiatives

In the aftermath of the November 1968 crisis, the Commission in February 1969 submitted to the Council a new memorandum entitled "Coordination of Economic Policies and Monetary Cooperation in the Community." This so-called Barre memorandum made suggestions for concerting medium-term economic policies—with respect to rates of growth of production and employment, price trends, balance of current accounts, and over-all balance of payments. It also called for better coordination of short-term policies, and for a Community mechanism for short- and medium-term financial aid. The short-term aspects of the Barre plan were approved in January 1970 and the various medium-term aspects have been or shortly will be submitted as draft decisions for Council approval.

The short-term arrangements, as implemented by the Council, provide credits up to one billion dollars available automatically on application and a further one billion in drawing rights available on a standby basis. The drawings of individual countries from the first billion are limited to the amounts of their quotas—30 percent each for Germany and France, 20 percent for Italy, and 10 percent each for the Netherlands and Belgium-Luxembourg. The second portion is available in theory for any country up to one billion dollars, but in practice the central bankers, whose approval is needed for drawings on this sum, might be reluctant to see one country draw up to the limit. Short-term support is initially for three months; it can be renewed once if agreement is reached on measures the deficit country should take to correct its situation. Moreover, in connection with these arrangements for short-term currency support, the member states are agreed that consultations should take place within the relevant Community committees before any member introduces short-term economic or fiscal measures likely to have repercussions on another.

The principal significance of the short-term agreements was, as Barre had originally intended, to lay the groundwork for medium-term support—and this in turn would make medium-term coordination of policies desirable. Although the short-term programs were accepted by the Six because there were no real alternatives, their shortcomings were widely appreciated at the time. For example, Guido Carli, governor of the Bank of Italy, said shortly after approval of the short-term credits that, despite pledges to the contrary, coordination of economic policies within the EC would be ignored when domestic considerations were strong. He conceded that the short-term credits were better than nothing, but that swap credits with the US Federal Reserve were much more useful in practice, an opinion shared by Italian Treasury Minister Colombo. (In March 1970, the Federal Reserve did grant Italy an additional swap credit of 500 million dollars, with no objections from Italy's EC partners, who were consulted.) Carli's conclusion was that it was doubtful that monetary cooperation and policy coordination could go very far within the EC without strengthened political cohesion.

Medium-term Aid and Policy Coordination

The medium-term arrangements asked for by the Commission are in fact an attempt to achieve some greater degree of political cohesion without having to make a direct attack on the problem of federal unity. Procedurally, its proposal for medium-term (two to five years) financial aid within the Community is intended to flesh out the inadequate and cumbersome guidelines for ad hoc action laid down in Article 108. The mutual assistance provided for in that article is intended to overcome balance-of-payments adjustment difficulties without having to resort to changes in exchange rates or to other measures prejudicial to integration. In contrast with the first portion of the short-term credits arrangement, there is nothing automatic about the proposed aid provided for by the medium-term scheme. Such aid can be extended only by a qualified majority vote in the Council on a recommendation by the Commission and after consultation with the Monetary Committee. Moreover, a qualified majority will decide on the conditions for the loan, including the economic policy commitments of the receiving country. Finally, the medium-term policy would require coordinated action by the Six if one of the member states seeks additional aid from another international organization.

The total sum to be available in principle under the medium-term aid is another two billion dollars, subscribed to in the same proportions as the short-term credits. The Council is scheduled to discuss the assistance scheme this fall, when it presumably will be taken up together with the general question of further steps toward monetary union.

The remaining aspect of the Commission's 1969 memorandum would commit the Community to coordinate medium-term economic policies—that is, rates of growth of production and employment, inflation trends, the balance of current accounts, and the over-all balance of payments. The aim would be to bring to light regional and labor situations of the member states, as well as disparities in the economic structures, and to bring about a convergence of their economic plans and programs, the periods of which now do not always coincide. The Commission's idea is to stimulate action by getting Council approval for medium-term (five-year) statistical projections of each country's GNP, employment trends, rate of inflation, and balance of payments. Since early this year, specific goals suggested by the Commission have been under discussion within the Community. Once agreed by the Council, such projections would presumably serve as terms of reference for national economic policy decisions.

Unified (or Common) vs. Coordinated (or Harmonized) Economic Policies

...unified economic policies are something much different from merely coordinated economic policies. The latter are defined and worked out on a national level and then compared with the view of possible minor adjustments. Unified economic policies, instead, are defined and worked out on a Community level rather than on a national level....It is hard to imagine the formulation of unified economic policies in the framework of the existing Community structures. Unified economic policies presuppose a continuing dialogue conducted on political and technical levels by bodies sitting with the necessary continuity.

—Emilio Colombo
February 1970

Toward Economic and Monetary Union

Following The Hague summit meeting in December, the EC Council appointed a committee to study the available options for a phased establishment of economic and monetary union. The committee is chaired by Luxembourg's Prime Minister and Finance Minister Werner—a longtime advocate of action in the monetary field—and the members are the chairmen of the five EC committees concerned with economic and monetary matters plus a representative of the Commission. None of these experts necessarily represents the official views of his government. Bernard Clappier, for example, Deputy Governor of the Bank of France and chairman of the EC Monetary Committee, told the US Embassy that he could not function effectively if he had to get formal instructions from the French Government—there being too many differing views in Paris for reconciliation within the timetable under which the Werner Group was working.

In the group's recent discussions the points of reference were four more-or-less specific plans for economic and monetary union offered by Werner himself, Belgian Finance Minister Snoy, West German Economics Minister Schiller, and the Commission. In addition to these plans, Italy's Colombo and German Bundesbank Vice President Emminger had recently made extensive relevant remarks. Also, as part of a study on "Problems of British Entry into the EEC" prepared for the Action Committee for the United States of Europe, Italy's Carli and Yale's influential monetary economist Robert Triffin, respectively, had recently presented cases for mobile parities in an intermediate period of Community monetary integration, and for a European Reserve Fund "to support and ensure within the Community itself the harmonization of monetary policies." The latter idea is also supported by Colombo.

Major Issues

Common to all these specific plans is a transition period to economic and monetary union of from eight to ten years, with movement to take place in from three to seven stages. Moreover, all of them envisage early completion of the Commission's proposals for medium-term financial support and policy-goals agreements. There are, however, four major issues on which the authorities tend to divide: (1) whether the stress ought to be placed first on reaching economic union—involving common policies on budgetary, fiscal, inflation, incomes, and balance-of-payments objectives—rather than on monetary union; (2) whether fixed exchange rates are compatible with differing national goals during the transition to monetary union and, if not, which will give way; (3) whether monetary union is possible without first achieving political union; and (4) how to enlarge the Community membership without impeding progress toward economic and monetary union.

The question of whether to give precedence to monetary or economic integration has assumed the dimensions of a doctrinal dispute despite the efforts of some, notably EC vice president Barre, to dismiss this as a false dilemma and to stress that parallel progress in both areas is necessary. The problem on a technical level seems to be that it may be easier to take certain monetary measures—such as to narrow the band within which exchange rates are permitted to fluctuate or to contribute a portion of national monetary reserves to a common pool—than it is to bring often widely disparate economic policies into line. These differences in national economic policies may in fact reflect such basic factors as differently timed business cycles, different political pressures, different vulnerabilities to external events, and differing exposures to internal trade-union power. Therefore, it could be dangerous, before a true economic union is achieved, to restrict the range of monetary measures and correctives available to the individual states to deal with their respective situations. This—overly simplified—is the position of the so-called "economists" in the debate.

The "monetarists" do not necessarily argue with the assumption that economic integration is inherently slower than monetary integration. But they would contend that monetary integration should provide the stimulus to move ahead, for example, in unifying commodity and capital markets—one of the conditions necessary for unification of economic policies. Werner, who is usually included among the "monetarists," in a January 1968 speech frankly characterized monetary unification as: "...a means of promoting economic integration which is very efficient and even sometimes brutal. It can end by forcing the economy into a new mold at the unfortunate price of tensions and pressures."

The "monetarists" would cite in support of this position the kind of problems that may arise for specific industries when monetary integration lags behind the real industrial integration encouraged by the customs union. An example of these problems is the demarche made to the Commission last June by important aircraft firms from five Community countries. Announcing their own increasing efforts to integrate and asking for Community action to help meet American competition, the firms noted that their cooperation in carrying out long-term programs would be hindered by the absence of guarantees against changes in exchange rates. So long as there is no "European" currency, they argued, exchange guarantees should be established in order to offset distortions resulting from possible changes in monetary parities.

Among the Six, the Germans—in part fearing the "pressures and tensions" to which "premature" monetary arrangements might give rise and in part fearing what they might have to contribute to reserves—represent the "economists' " wing. Schiller's plan, although carefully drafted to link economic with monetary measures in each of its four phases, would in fact require considerable progress toward economic union before monetary mechanisms could be activated. The French for their part have not provided any step-by-step version of their ideas on economic and monetary union, but it is clear that on the political level they emphasize early monetary measures as an earnest of Community "togetherness." Within this spectrum the Belgians and Luxembourgeois generally are closer to the French in stressing monetary elements, and the Dutch and Italians are closer to the Germans in giving higher priority to economic integration. The Commission advocates a parallel approach.

Closely related to the issue of priority of economic vs. monetary union is the question of exchange-rate adjustments. Many advocates of monetary union believe that the best approach is gradually to narrow the margins within which member-state currencies could fluctuate in relation to one another. Ultimately, margins among member-state currencies would be eliminated and the Community would function as a fixed-rate currency bloc with respect to the dollar and other third-country currencies. The French, Belgians, Luxembourgeois, and the Commission would introduce narrower margins at an early stage. The Germans and Italians favor postponing the narrowing of margins until later phases of economic and monetary union.

Those who favor such a delay do so in part because they doubt the early feasibility of correcting every disequilibrium among the member states with the immediate and finely tuned adjustments of national policies that would be required. They would also allow for the possibility that, in the current pattern of exchange rates, some of the currencies may prove to be under- or overvalued. Thus, the Italians advocate a system that would, in Carli's words, "admit, within limits to be decided (2 percent per annum at the most), monthly or quarterly devaluations or revaluations." These would "compensate and correct the disequilibrium persisting in the evolution of national prices and costs, and so maintain a greater stability of competitive conditions." This concept has apparently not found much favor within the Community, although Carli claims that the very *uncertainties* in the exchange market introduced by his scheme would put pressure on governments to accelerate the coordination of their economic policies.

The Commission, on the other hand, believes that to increase exchange-rate flexibility within a budding monetary union is absurd and argues that the greater policy cooperation among the Six resulting from even the early stages of economic and monetary union would serve to make parity changes more "orderly." If policy coordination has not been able to overcome basic imbalances and thus avoid the need for exchange-rate adjustments by the member states during the transition period, resort could be made to the traditional one-time devaluation or revaluation techniques.

Although it is evident that the achievement of all the steps required for effective economic and monetary union would carry the Community very far toward some kind of federal Europe, there is not at this point any disposition to face up to this fact. The "pragmatists," such as the Commission, prefer to speak of the progressive creation of a "functional" economic and monetary union stopping short of an actual federation, which Barre says, "for obvious political reasons would be more difficult to achieve within the same period."

Nevertheless, the question of national vs. Community sovereignty will arise at each stage of the enterprise and become more pressing with each further advance. In connection with the medium-term policy proposals now under discussion, the contentious issue of majority decisions has already been raised. The preference of the French for a certain automaticity in monetary measures is probably related to their distaste for the majority voting that economic policy coordination probably requires if it is to be more than a facade. Moreover, the future powers and responsibilities of the European Parliament—already a sensitive question—can hardly be ignored forever. As the Community moves toward harmonizing economic policies and creating common monetary mechanisms, the member states will be relinquishing to Community councils grave responsibilities while they themselves remain the politically accountable authorities—unless accountability is transferred to the Parliament.

Naturally, none of the member states wishes to face this dilemma squarely, and—depending on the economic and political climate and the skill of the Commission—it may be possible to avoid the kind of confrontation that occurred in 1965 when De Gaulle sought to prevent a further extension of the majority voting scheduled to occur at that time. But the question of how to run an economic union of the Community's dimensions cannot in the long run be left unanswered.

The Werner Group Report and its Reception

The interim report of the Werner Group, as presented to the Council meeting of 8-9 June, sketches the situation at the "point of departure" for economic and monetary union and outlines the scope of the union at the "point of arrival." At the last stage, for example, there would be effective Community organs, having well-defined responsibilities with respect to "democratic rules"; and labor would participate at the Community level in working out an incomes policy. The report then spells out at greater length the [redacted] 25X1

Barre on Economic and Monetary Union

Obstacles

First, there are technical obstacles: the problem now is not to eliminate quotas or tariffs, but to harmonize the economic, fiscal, monetary and social policies of the member countries and to hammer out common policies in all the fields where they are needed.

Then there are political hurdles to be overcome: the drive to build up our Community is now encroaching on areas directly affecting the responsibility of governments to their parliaments and public opinion. Here we must tread carefully...because we are attempting to align national policies at the very moment when economic, social, intellectual and even moral protest is the order of the day in all our countries.

Finally, there are international difficulties: a Community gradually gathering economic and monetary strength will acquire a new degree of influence. This is bound to change the current system of economic and monetary relations, upon which at the present time no single member state can have anything more than a very limited impact. So it is not surprising that a stronger Community is a source of concern in some parts of the world and is not welcome everywhere.

Favorable Factors

If the Community countries really want to safeguard and increase the agricultural, industrial and commercial advantages of the Common Market...sooner or later they will have to accept, whether they like it or not, a fuller and more effective economic and monetary organization of the Community.

...an organized Community monetary grouping, with its own individuality, within the international monetary system is a growing necessity. For not only must the specific interests of the six countries be safeguarded, but a better balance of forces must be established within the international monetary system ensuring that international monetary cooperation can function harmoniously.

The monetary disturbances which afflicted the community in 1969 and the serious difficulties the international monetary system ran into have made the public more and more sensitive to the internal and international monetary aspects of our community venture: only the specialist can really grasp how the elaborate and sophisticated machinery works, but the public has realized how important it is in practice and in politics.

—From a speech in Bellagio on "The European Economic Community in the '70s," June 1970

proposed actions for the first phase. At its June meeting, the Council "noted with satisfaction" the conclusions of the Werner Group's interim report, and this has been widely taken as signifying Council agreement with the principles outlined. In summary, these state that:

—the Council must rule before the end of 1970 on medium-term quantitative economic policy guidelines and on the introduction of medium-term financial aid;

—the ultimate objective appears attainable within the present decade, provided it receives the permanent political support of the governments;

—the necessary powers for economic policy decisions will be transferred from the national to the Community level, and this could eventually lead to a single currency;

—action in the transition period will be taken simultaneously and progressively on a number of fronts. Although some measures will require amending the Treaty of Rome, the present provisions already permit substantial progress;

—a period of three years from 1 January 1971 for completing the first stage appears suitable from the technical point of view. This stage is intended to render Community instruments progressively effective and to mark the beginning of the Community's "identity" within the international monetary system;

–the first stage should include a tightening up of consultation procedures, conducting of budgetary policy by the member states in the light of common objectives, introduction of some degree of fiscal harmonization, close coordination of monetary and credit policies, and stepped up integration of financial markets;

–the Community should progressively adopt common positions in monetary relations with nonmember countries and in international organizations and, in particular, must not avail itself of any provisions that might render the international exchange-rate system more flexible.

How much of this can be accepted as formally "agreed" remains to be seen. The Germans still seem to stress the necessity of progress on effective economic cooperation prior to monetary commitments, and the Dutch may be reluctant to move very far at all before the British are brought into the negotiations. In any case, the Werner Group report itself notes the so-far unreconciled divergence among its members on monetary measures that should be taken during the first stage. The report presents two options: on the one hand, a limited reduction of Community exchange margins should be undertaken during the first phase, supported either by a fund for exchange stabilization—the functioning of which is spelled out at length—or by coordinated intervention on the exchange markets by the central banks. Alternatively, such specific monetary action—perhaps both premature and too risky in the first phase—should be deferred in favor of further steps toward the harmonization of the economic policies and situations. The Council hopes that the Werner Group's final report in September will include suggested compromises.

Economic-Monetary Union and the British

Monetary problems are bound to play an important role in the negotiations on British accession to the Community, but there is so far little information on the respective negotiating positions. In general, the Commission's view is that, at the time of entry, the UK and the other candidates will have to take the same measures that the present EC countries have taken. In its March 1970 proposal, the Commission noted, moreover, that progress toward economic and monetary union could in fact help solve some of the problems that both the Community and the candidate countries will face as a result of the Community's enlargement. The British, for their part, have welcomed the moves the Community has already made toward economic and monetary integration and have expressed a readiness "to play our full part."

The problems for Britain in the monetary area are, in the first place, the adverse impact on its balance-of-payments that its participation in the Community may have—at least at the beginning. Although the British fully expect the long-run effects of accession to be beneficial, the initial influx of imports from the other Community countries, a possible outflow of British capital, and the contributions that London will have to make to the Community's financing could at the beginning cause sizable deficits. Secondly, there is the question of the sterling balances owned for the large part by members of the sterling area abroad. It is feared that these balances make Britain particularly vulnerable to speculative crises, although immediate concern on this score has lessened as a result of the 1968 Basle arrangements aimed at underwriting the value of the holdings. Various proposals involving consolidation of these overseas sterling balances, possibly combined with the creation of a European Reserve Fund, have been made in connection with Britain's joining the Community. Triffin, for example, argues that the Six individually already have to act as creditors for Britain in various international support arrangements and might as well make a virtue out of necessity by acting as a unit.

A reserve fund could also play a role in meeting the first problem--i.e., an early deficit on current accounts. Although there seems to have been little discussion yet at the Community level of the modalities of a reserve pool, it could support sterling during a transition period when Britain's reserves might be under pressure. On the other hand, the suggestions of Carli and others that British entry could be facilitated by the introduction of limited exchange-rate flexibility both on an international scale and, for an interim period, within the Community seem unlikely to get very far in view of the agreement among the Community members not to apply among themselves any widening of exchange rate margins that may be authorized at the international level. Moreover, those members that oppose adoption of greater international exchange-rate flexibility are likely to press the UK to take a similar position.

International Implications

The question of British support for the studies now under way within the International Monetary Fund on greater flexibility in international monetary exchanges is thus also closely linked with the UK's negotiations with the Community. Inasmuch as the US is interested in pursuing such studies at the international level and France is the chief opponent of introducing more flexibility, the British—aware that the outcome of the entry negotiations depends in large part on France—are to some extent caught in the middle of another potential US-French monetary skirmish. In any case, because the Community as a whole remains divided on international flexibility—with the Belgians siding with the French, and the Germans, Italians, and Dutch willing to consider the various proposals for moving away from fixed rates, it is clear that agreement in the IMF on exchange-rate reform will probably have to await a common Community position. A Commission official told the US mission in mid-July that the Community expects to reach a decision on this issue in the fall, but this may be optimistic.

Even if some consensus on principle were reached, it would seem that implementation of an international scheme would have to await further progress in the Community's achievement of economic and monetary union, as well as a commitment by Britain to its content and procedures. In order to move as a bloc vis-a-vis outside currencies in a world of greater exchange flexibility, the Six would have to achieve greater monetary unity among themselves. For example, are the Germans, who favor more international flexibility, yet ready for more monetary unity within the Community? Or are the French, who might be less opposed to international flexibility if it would lead directly to increased intracommunity solidarity, nevertheless willing to relinquish the degree of national monetary control required for movement toward such unity? Despite the delays the Community may cause, however, its proposed common economic and monetary policies are designed to foster stable relationships that would eliminate intracommunity problems as a potential source of international monetary crises.

Outlook

In any case, these complex questions may suggest not only the difficulty, but also the importance, of what the Community is trying to do. With the establishment of the customs union and the common market for agricultural products, the Community has emerged as the world's largest trading unit. As has been amply demonstrated already, the Community's commercial policy carries clout, and how that policy is made and by what Community interests it is influenced have become vital concerns of the international trading world. The Community's influence in international monetary affairs is potentially no less—provided it combines its resources, concerts its policies, and speaks with one voice. But whether the stabilizing potential of this development will be fully realized will likewise depend on who or what determines the Community's policies.

The problems and the opportunities the Community faces internally are comparably staggering. The Community's gross national product is already second only to that of the US. The [redacted] 25X1

instruments by which Washington gives the US economy direction and stability—the huge federal budget, the income tax, and the Federal Reserve system with its controls over credit policy, etc.,—materialized as the country grew, and as the federal system of government developed over a period of nearly two hundred years. Brussels is allowing itself a little over two decades to produce instruments that it hopes will be—if not comparable—at least reasonably effective. [redacted] 25X1

* * *

Approved For Release 2008/11/04 : CIA-RDP79-00927A008100030001-1

Page Denied

Next 21 Page(s) In Document Denied